For Distribution

Remarks of
Chairman James J. Hoecker
Federal Energy Regulatory Commission

"Time to Join The Revolution"

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I.

As things stand today, it is possible and perhaps likely that this will be my last address to NARUC as chairman of the FERC. I am tremendously proud of my colleagues and our dedicated staff and of what we have accomplished and endeavored to accomplish during the last three and one-half years and, indeed, over the course of the last decade. And, it is with good wishes and appreciation that I commend the community of state regulators for their attention to energy issues -- however we might agree or disagree.

Of course, I would be more pleased -- as would you, I know -- if the restructuring of the Nation's bulk power markets were as well-advanced and as widely accepted as the restructuring of the interstate marketplace for natural gas. I dislike leaving such important work unfinished; but, more realistically, it is the absence of common cause among public policymakers that is most frustrating. Today, I doubt we could all accede, even in general terms, to a shared vision of what this large and most critical of industries must become and that too is very troubling to me. And it is the uncertainty that is fed by widely disparate proposed market solutions that threaten consumers, jeopardize additional investment, and cloud the prospects for a smooth and methodical transition to the rational market for power we all expect and require.

The NARUC meeting this year occurs at a moment of great uncertainty in our national life, to be sure. We

are meeting at the very epicenter of the controversy over electric restructuring. The electricity portions of your program allude to an industry restructuring that is rough and tumble, brutish, confusing, endless, and unpredictable. What do you think this is? A Presidential election?

II.

No one, absolutely no one, is more keenly aware of the challenges ahead in this area than are you and I. But, I say to you today that the competitive revolution is here. We must meet its challenges. We cannot sit it out. Technology has forced the issue; smaller plants and better computers have changed the market. New entities willing to shoulder market risks are diversifying the environment we regulated for so long. Major generation assets are on the block. Corporate consolidation is accelerating. Utilities are moving heavily into unregulated activities and investing overseas. The volume of transactions on the

electricity grid has increased 400 percent in four years. This is a much different environment than existed just a decade ago.

The stresses on the system are easily recognizable. The causes of those stresses can be identified. And, with that in mind, solutions must be developed. This is not to underestimate the difficulty of the problem. Between 1995 and 1999, domestic demand for electricity increased 9.5 percent while total additions to electric generation rose 1.6 percent. Energy efficiency spending by utilities declined by 50 percent, magnifying the problem of demand growth. Referring to the potential for severe power outages, EPRI says that "North America is closer to the edge . . . than at any time in the last 35 years." And, because we have not yet shorn companies of the advantages of incumbency or ensured that markets will effectively manage the growing chasm between supply and demand, the DOE stresses that "electricity supply in certain areas of

the country is highly concentrated in the hands of only a few companies," and warns that high prices and an unhealthy level of price volatility could be the result.

Before you throw up your hands, let me remind you that the average price of electricity in the U.S. has decreased for six consecutive years for all customer classes, according to EIA. States that had moved the farthest toward retail access lowered customers' bills the most. California's market, for all its struggles, was responding as well if not better than regional markets in the East. Moreover, this once-staid industry, with its undernourished infrastructure, is suddenly generating an unprecedented kind of enthusiasm among Wall Street investors. And transmission open access portends a new level of market appeal for renewables. At this juncture, in other words, we have no reason to think that the billions of dollars in

savings to consumers forecasted from more competitive power markets cannot be made to materialize!

I know what some may be thinking. Tell <u>that</u> to the electricity consumers in San Diego. Tell them, Mr. Chairman, that the enormous price they paid for the collective miscalculations of public policymakers, exacted from them by the forces of an immature and capacity-short market, will be worth it in the long run. Obviously, I cannot do that. The price paid by this town was unacceptable. If I were a senior citizen living on a fixed income, or a small business owner operating on a slim margin, or a school administrator who cannot spare any of the scarce dollars needed to serve students, a sudden doubling or tripling of my energy bill would make me feel vulnerable and even outraged. I doubt I would be the least comforted by the Commission's proposed redesign of California's wholesale markets –- forward contracts, remedies for under-scheduling, reconstituting the ISO board, and

expanded bilateral markets. I don't think the CPUC's cautious measures would make me feel any better. Instead, I would simply want my money back. At a minimum, I would want some assurance that I would be able to protect myself from such eventualities in the future. While the Commission is currently putting in place measures which will minimize the chance of another such occurrence, and may transgress certain aspects of the California restructuring formula as a consequence, we are painfully aware of the legal limits on our ability to rewrite last summer's unfortunate history.

In the final analysis, we can all agree that the California market proved brittle under stress. Ratepayers had no alternatives and no warning. Their only suppliers, like SDG&E, had been given almost no flexibility at the state level and the FERC had forged quite inadequate protections against what now seems like a market's inevitable response to scarcity and

market power. Let's ask the tough question. Did the FERC err in working so hard to implement a single-state wholesale market, designed by progressive and well-intentioned legislators, and carved into California law without flexibility or the benefit of technical experience? Yes, I believe we did. If we let it happen again, shame on us.

But, what now? Now that we have stepped into that busy thoroughfare called electric restructuring, now that markets have been changed, generation facilities sold, planned, or built, now that the extraordinary costs of a regional grid information system are sunk -- do we retreat or retrench?

I realize that, in part because of California, several states will be tempted to back away from retail customer choice. It seems equally plausible that the new Congress, as evenly divided as it evidently will be, will balk at the challenge of restructuring

legislation and reliability reforms. And I know that the energy-consuming public, which is often told that the only defensible alternative to a fully regulated monopoly is complete deregulation and abandonment of traditional public interest protections which are now denigrated as mere market meddling, understandably dislikes the risks associated with "deregulation." Yet, the changes taking place in this industry are not something we can choose to stop. They must be accommodated, or advanced, or constructively channeled or curbed. If we don't step up to that task and move ahead, who will?

I think of our dilemma -– stranded in traffic mid-transition –- this way. We now live in a global economy and most of us have conceded (or should concede) that free trade is here to stay, whatever you might think of China's human rights policies or having your shirts made in Honduras. Our prolonged economic boom is in no small measure a result of it. Yet,

inevitable as are the forces of the global economy, legitimate concerns persist about the effect that globalization is having on our workers, about workers' rights in other countries, and about how to safeguard the environment. To quote Dan Yergin, "The sense of triumphalism that characterized global capitalism just three or four years ago is no longer there." And Alan Greenspan expressed his own fears that a recession could force a retreat from market-oriented policies and a return to protectionism in the U.S. In other words, we ignore or fail to deal with the unexpected and adverse consequences of oversized developments like globalization at our peril. But, when troubling issues arise, do we advance or retreat? Struggle as we might to square our values and our economic self-interest with the global environment, we can neither run from it nor assume it will inevitably turn out right for everyone. We must shape it to our highest and best purposes. We should recognize that we have that responsibility.

For electric restructuring, we must do the same. Recent events in California and elsewhere have been sobering. But (practically speaking) we cannot re-regulate, we cannot return to the old days of regulation that strangled investment and innovation, we cannot undo the massive transfers of assets that have occurred already, and we should not choose automatically to suppress the competitive dynamics of the industry today. We must move forward, learning the lessons that this and many other experiences teach us, collaborating to make the transition to wholesale competition swift and smooth, and embracing key shared objectives that will produce benefits for consumers sooner rather than later. We at the FERC have a heightened responsibility to address the legitimate concerns of the consumers at the end of the value chain, who (we tend to think) are someone else's responsibility. Yet, I also believe that state regulators have a new responsibility as well; it is not necessarily to accede to the wishes of Washington; it

is, however, to ensure that the regional energy markets that serve and surround your states perform well for everyone in the region and not just your constituents. Modern markets for power will not work any other way.

You will not be surprised to know that the Commission is persuaded that the future success of the bulk power markets lies in the efficiency, transparency, and fairness that better regional grid management offers. Regional transmission organizations (RTOs) will be the market facilitators of the future, holding the transmission network open to greater competition for customers among electric generators and other sellers of power. With potentially massive generation shortfalls staring us in the face in the next three to five years, RTOs are no longer a mere policy option; they are a necessity! Despite the critical and widely recognized importance of the transmission network, the annual dollar investment in transmission facilities has actually declined 15 percent since 1990. You can almost feel Wall Street hesitating as it tries to discern the emerging strategy of transmission-owners, the direction and resolve of public policymakers, and the viability of a future "wires" business. These uncertainities are paralyzing market development. You begin to wonder if "off-road" solutions like distributed generation which may eventually leave transmission -– and its regulators –- stranded may emerge as the best long-term answer by default. However, one thing is certain. You can clearly see right here and now that, with some notable exceptions, incumbent transmission owners have failed to seize meaningfully upon the Commission's invitation in Order No. 2000 to move voluntarily but aggressively toward a reconstituted bulk power environment from which vertical market power is expelled. I firmly believe today the industry would have fewer strategic uncertainties (or fewer places to hide, as the case may be) if states and the FERC were working in tandem to create value in the market, to open up new opportunities, and to create sizeable regional markets designed according to the physical realities of the electrical system and the regional needs of bulk power producers and sellers.

The choice for regional markets is a choice <u>you</u> can help us make. Granted, you can decide whether consumers in your states have the basic economic right to choose energy suppliers and whether they have real competitive options. You can choose to site a new plant or refuse to. You can decide whether a utility's assets are sold and to whom. You can ensure retail service reliability. You can affect the results of electric restructuring in a hundred ways that will never be "federalized." You can also choose to expend your time and treasure in court myopically trying to secure state control of most of the transmission system. Those are all real choices.

State officials nevertheless do not have the power to decide that the electricity system is not interstate in nature or that your state does not participate in interstate commerce. I do not think any one of you can, or should want to, stem the tide of the competition revolution -- much as some may wish to try -- any more than this country could simply withdraw from the global economy. The only relevant question in my mind is: How long is real change going to take and what is the cost of delay? It is a most difficult question and I confess –- for myself, the Commission, and the citizens of San Diego -– that I am getting impatient. State and federal regulators are both –- along with the Congress –- responsible in part for finding the answer to that difficult question of How Long? Not long?

III.

The Department of Energy estimates the benefits to the economy of full electric competition at $20 billion

per year. I have no way of judging whether that is too high or too low. What I <u>do</u> know is this:

> The United States has been a world leader in introducing competition to monopoly industries.
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> The savings from those efforts in other industries have run to billions of dollars and, in my estimation, has contributed mightily to our prolonged economic boom.
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> Valuable new services and innovations that have resulted from competition, competently planned, has improved the quality of life for average Americans.

We must dispel the cloud of uncertainty currently hanging over this industry's future. Whether or not your state opts for retail choice, the wholesale market needs your help and your state needs a vibrant wholesale market. I believe the real efficiency benefits that can be gotten from a seamless grid can and will be delivered to the energy consumers in your state. The Commission has always known it cannot do it alone. Thus far, the Congress has chosen to sit out

the revolution. For that reason, we need <u>your</u> leadership to help make this happen.

In return for your commitment, I think that federal regulators must look for more workable forums within which to collaborate and, where appropriate, share decisionmaking. I do not propose joint boards with complex statutory requirements that are national in scope and responsibility. If electricity markets are regional, then the monitoring oversight of RTOs in the public interest can also be regional. For every RTO, I would propose to have a standing Regional Regulatory Organization or RRO, comprised of state and federal regulators, to ensure that planning and reliability policies are both workable and non-discriminatory, that the scope of the RTO is appropriate, and so forth. An RRO could devise its own charter and procedures. I believe its members would spend less time pointing fingers and filing suit and more time collaborating on constructive solutions. I think we are both being

given a wake-up call by current events and a chance to hasten the advent of competitive markets, to promote real price signals and demand-responsiveness, to deliver the benefits of a truly modern electricity system to real consumers and in the foreseeable future, and to breathe some life into the federalism that characterizes our regulatory system and which we all too often fail to capitalize on. There's no time like the present to join the revolution for competitive wholesale markets.

Thank you.